FINAL

Arizona State Land Department Mitigation Alternatives Analysis

November 12, 2014

Summary:

The goal of the Mitigation Alternatives Analysis was to review the available mitigation alternatives to determine the best approach for establishing a habitat mitigation program on ASLD predetermined parcels which are unsuitable for development to maximize revenue generating potential to achieve the highest and best use for the beneficiaries. The other major criteria for selecting an appropriate program was to ensure that ASLD would not be taking on any liability associated with these projects or substantially increasing staff or program costs. Assuming that the use of undevelopable habitat lands meet all the legal and fiduciary requirements as the highest and best use of the lands, it was determined that the recommended approaches and actions items include: 1) identifying those ASLD land holdings that would be most suitable for habitat values; 2) developing a process for noticing and making those parcels available for sale or lease to habitat developers; 3) establishing a process for assuring highest values from a fee on lands and percentage of future revenues; 4) identifying opportunities on ASLD development lands for the sale of those lands tied to the equivalent sale of ASLD habitat lands on the same parcels; and 5) encourage use of ASLD habitat lands with existing mitigation providers (e.g., ILF/HCP's) and green investors.

Purpose of Mitigation Alternatives Analysis:

To review and analyze the various alternative forms of habitat mitigation programs and develop a model to compare and contrast the various alternatives against the overall goals and criteria of the Arizona State Lands Department (ASLD) to identify potential approaches to determining the highest best use of the ASLD habitat lands not suitable for development for the beneficiaries.

Background:

Under current federal and state regulatory laws, habitat offsets or mitigation can be required when impacts to various types of environmental habitat or species occur. The two biggest drivers of habitat offsets in Arizona typically fall under the purview of the federal Clean Water Act (CWA) for wetlands and "waters of the United States" and the federal Endangered Species Act (ESA) for impacts to listed species or their habitats (Section 7 and 10).

In order to address impacts to wetland and species habitats a number of different mitigation alternatives can be used. Three primary mitigation approaches used today are: permittee responsible

mitigation (PRM), in lieu fees (ILF), and mitigation and conservation banks. The following provides a general description of the various mitigation alternatives:

- Permittee Responsible Mitigation (PRM): Mitigation undertaken by the permittee (or authorized agent or contractor) to provide compensatory mitigation/offsets for which the permittee retains full legal responsibilities;
- In Lieu Fees (ILF): A program in which funds are paid to an entity (typically governmental or non-profit) which agrees to provide wetland or species habitat to satisfy compensatory mitigation requirements. It should be noted that for species offsets, a habitat conservation plan (HCP) can also be structured so that fees can be collected prior to project implementation similar to an ILF;
- Mitigation/Conservation Banks: A site or suite of sites where resources are restored, enhanced or preserved for the purpose of providing compensatory mitigation/offset for impacts to authorize under the permit where the liability is transferred to the bank sponsor. Mitigation banks typically referred to as "wetland banks" (CWA rules) and species banks are referred to as "conservation banks" (ESA rules and guidance) and a single bank may have wetland and species credits at same location (then referred to as a mitigation bank).

There have been extensive studies about the pros and cons of each of these approaches and there are even some governmental programs that have rated certain approaches as better than others. For example, the U.S. Army Corps of Engineers mitigation rule for wetland mitigation provides a preference for wetland mitigation banks over in lieu fees and permittee responsible mitigation.

The following lists the general ecological and regulatory pros and cons for the three mitigation alternatives:

<u>Permittee Responsible Mitigation:</u>

- Pros: Liability of project remains with responsible party; mitigation implementation is required prior to or concurrent with project implementation;
- Cons: Non-environmental professionals implementing offsets; increased permitting time and costs especially for a small project as compared with other forms of mitigation; little or no incentive to ensure project success, most mitigation is done after the impact is done, higher ratios for mitigation offsets are often required;

<u>In-Lieu Fee's:</u>

- Pros: Reduces permitting and project timelines, work done by environmental organizations (non-profits/government), mitigation projects implemented on larger habitat areas;
- Cons: Temporary loss of wetlands/species habitat since project implemented after impacts; difficult to determine future costs of projects;

Mitigation/Conservation Banks:

- Pros: Larger project sites; work planned and implemented in advance of impacts; reduces permitting and review timelines; performance standards (biological, legal, financial); liability transfers to bank sponsor/mitigation professional from permittee;
- Cons: Results in relocation of habitat/species from impact area; can take substantial amount of time and resources to get banks permitted;

Note: Often cited issues related to habitat mitigation such as uncertainty over habitat restoration or enhancement; temporal losses related to offsets; failure to meet no net loss standards associated with preservation as a mitigation tool; lack of resources for future land management and monitoring were not listed in this section as they could apply to all of the listed alternatives equally.

Mitigation Alternatives Analysis Screening

It is generally accepted that no one program is appropriate in all circumstances and the various mitigation alternatives need to be evaluated on a regional or programmatic basis to fit the needs of a particular project, region or entity. For example, in areas with relatively robust demand for mitigation and substantial amounts of available land holdings, wetland mitigation banks and species conservation banks are a good way to provide mitigation offsets. In areas with limited demand or very specialized or localized demand, payment into an ILF may be the most practical. Finally, permittee responsible mitigation may be the best approach for a larger impact when no other mitigation alternatives are available. Therefore, in order to compare the use of the various alternatives it is important to first, identify which of the pros and cons are most relevant to the decision makers and second, outline a specific set of criteria for program selection that promotes the goals of the specific entity.

For example, while ASLD values the environmental benefits and regulatory efficiencies related to the various mitigation alternatives, its constitution mandate is for ASLD to provide the optima value from its land holdings and obtain the highest return on land values to the beneficiaries of the state (public). Thus, ASLD must prioritize the economic value and return aspects of the various mitigation program alternatives over those of just environmental and regulatory benefits. Unfortunately, the majority of critiques evaluating the various forms of mitigation are focused on the ecological viability of these programs, with few comparisons of the mitigation approaches based on market or landowner values.

The following lists the economic, financial, and legal pros and cons for project proponents and land owners associated with the various forms of habitat mitigation programs:

Permittee Responsible Mitigation:

- Pros: Permittee has greater cost control over mitigation implementation; Permittee has similar economies of scale and project efficiencies related to large mitigation projects; Land owners can obtain higher returns on lands from permittee's who require specific habitat or species lands;
- Cons: Per acre costs of habitat offsets can vary greatly for smaller projects; Liability stays with permittee;

In-Lieu Fee's:

- Pros: Planning and implementation costs can be provided by third parties; Ability to request large service/market areas for compensatory impacts; Land owner can set prices in advance of sale (reduce market fluctuations); Ability to control/influence market demand; Public entities can capture greater market share by pricing credits below competing rates;
- Cons: Difficult to determine project costs in advance of project implementation; Lack of certainty over future demand; ILF/HCP programs approval can take several months to a couple of years to be approved; ILF sponsors assume liability associated with permit implementation;

Mitigation/Conservation Banks:

- Pros: Economies of scale for project implementation; Can charge high prices related to small projects; Potential return on investment in high demand areas; Land owners can get higher prices than non-development comparable land values; Land owners can increase current demand for their lands;
- Cons: High upfront capital expenses; Bank approval can take several months to a couple of years to be approved; Bank sponsors assume liability associated with permit implementation; High costs or responsibilities associated with long-term maintenance and monitoring;

Selection Criteria

In addition to the overall economic, financial and legal pros and cons associated with these mitigation alternatives, ASLD will need to further define their own selection criteria to determine how best to deal with their habitat lands and apply to the alternative mitigation approaches. Thus the following criteria and project parameters deemed most beneficial to ASLD land holdings, constitution requirements, existing land holdings and organization capacities and goals were developed to further screen the mitigation alternatives.

The following list are proposed criteria that the ASLD may use to select the best mitigation programs for its program:

Goal

Develop a habitat mitigation system/program that the ASLD can implement on predetermined parcels with unsuitable development potential as a revenue generating means for their highest and best use. The ASLD will determine the parcels on which such implementation is appropriate, based on the degree to which such lands are otherwise developable. While the mitigation system/program will be designed to provide the greatest benefit to State Trust lands, any potential action will be delivered in a way that ensures the ASLD will continue to fulfill its inviolable fiduciary responsibility to the State Trust by prioritizing overall economic interests over mitigation interests.

Proposed Components of Goal

Use the system/program to achieve optimal economic value of parcels determined by the ASLD to be appropriate sites on which to use the system/program.

To the extent possible, minimize the internal and external complexity involved in pursuing the maximum value for lands by developing an efficient and effective habitat market, while continuing to meet the fiduciary demands of utilizing land for its highest and best use.

Develop a program that minimizes the overall costs and liabilities to the ASLD by creating opportunities for other parties to engage in mitigation on Trust lands, while ensuring that the ASLD continues to focus its limited resources on fulfilling its fiduciary duty to the Trust.

Create opportunities for other parties to participate in this increasingly efficient demanding market.

→ Provide mitigation opportunities to the public and private sector, while continuing to comply with the constitutional mandate that the ASLD put lands to their highest and best use in an effort to generate revenue for the Trust.

→ Reduce permitting and regulatory burdens to the extent allowed under state and federal law.

In addition to the proposed selection criteria, it is also important to consider ecological outcomes as regulatory agencies will require these to provide value to habitat lands.

Comparison of Mitigation Alternatives and ASLD Selection Criteria

In order for ASLD to determine the most viable approaches to developing habitat mitigation on their lands, the Consultant in consultation with ASLD staff, developed a table comparing the various mitigation alternatives in relation to the ASLD selection criteria. Given the stated desire by ASLD to not assume any liability with individual projects nor substantially increase staff or program costs, the current proposal assumes that ASLD will develop a programmatic approach to how they will determine the highest and best use of these habitat lands but all implementation of the actual habitat mitigation projects will be done by third parties. These public or private third parties will be totally responsible for all liabiliites, development costs and future management and monitoring of the mitigation projects and will follow all of the current applicable ASLD land sales procedures and processes.

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The table assumes that: 1) the individual mitigation projects would be implemented by third-parties; 2) "Yes" means that the mitigation program would meet the selection criteria or "No" it would not. The results are based upon available literature and best professional judgment, and reflect the general implementation tools associated with the mitigation alternatives (individual programs may vary).

ASLD Selection Criteria/Mit. Alt	PRM	ILF/HCP	Mit/Cons Bank
Achieve Optima Value for ASLD Habitat Lands	Yes	Yes	Yes
Minimize Internal/External Complexity	Yes	Yes	Yes
Minimize ASLD Costs/Staffing/Liabilities	Yes	Yes	Yes
Allow Public-Private Partnerships	Yes	Yes	Yes
Other Factors: [non-ASLD factors]			
Provide Mitigation Opportunities	Yes	Yes	Yes
Market Efficiencies for AZ Business/Public	No	Yes	Yes
Provides High Quality Mitigation	No	Yes	Yes

The table highlights the following key points related to ASLD holdings and program:

- Any of the mitigation alternatives could be used on ASLD holdings;
- PRM's could be done on existing holdings, but may not provide the best market efficiencies for projects;
- If ASLD lands were used by third parties to establish their own ILF/HCP programs or mitigation/conservation banks these would provide greater market efficiencies and result in higher quality ecological outcomes than smaller PRM projects;
- Finally, the use of public or private partnerships would allow ASLD to use their lands for any of the mitigation alternatives (ILF/HCP and mitigation/conservation banks) without a substantial increase in costs and staffing (land disposition only) and with no program liability, while still obtaining market values for their lands.

Other Factors:

- Use of ASLD lands not suitable for development due to environmental and habitat constraints could provide a benefit to all stakeholders in Arizona;
- ILF/HCP and Mitigation/Conservation Banks provide the greatest benefit to other stakeholders in Arizona.

Recommended Approaches and Action Items:

Based upon the goal of obtaining the highest value for habitat/mitigation ASLD and the selection criteria established, we have developed a list of recommended approaches and action items.

All of the recommended approaches will require at minimum the following activities which include:

- Determination of constitutionality of using ASLD holdings for habitat/mitigation;
- Low level habitat value assessment of wetlands, waters of U.S. and current/future species habitats;

- Development of allowable legal, financial, contractual and business arrangements for land use and/or disposition.

Based upon successful determination that habitat lands may be considered the highest and best use and that their disposition (sale/leasing/optioning) meets all of the constitution requirements of the State of Arizona, then the following recommended actions and approaches may be considered:

1. Identify and Value Lands for Habitat Purposes
    a. Using existing GIS maps (wetlands/waters/species/wildlife corridors) identify habitat lands that provide "highest and best use" for habitat mitigation
    b. Determine current and future development opportunities on ASLD parcels and estimate potential amount of necessary habitat offsets and designate those lands for mitigation (use of an HCP would ensure future permit certainties and provide efficiencies to permittees)
2. Review constitution mandate for use of ASLD holdings to ensure that the use of habitat lands for habitat offsets complies with all legal requirements.
3. Develop ASLD specific sale or disposition requirements related to habitat mitigation lands such as:
    a. Sale of fee title or long-term lease of lands for habitat mitigation (Note: Lease of lands may not be allowable under all federal CWA/ESA requirements)
    b. Ability to use option approaches on land for future mitigation
    c. Ability to require buyers to perform all planning costs with mitigation sponsor and/or contractor
    d. Develop use agreements for all mitigation lands
    e. Develop purchase arrangements such as base land fee with percent of profits from future unit sales (e.g., acres or credits) or percentage of overall values
4. [Optional] Establish self-mitigation for all ASLD holding which would designate specific mitigation sites for all parcels and would require all purchases of fee title lands to require the necessary mitigation from ASLD:
    a. Designate the development lands and their habitat mitigation offset site for all parcels;
    b. Estimate habitat offset amounts and/or ratios for parcel developments;
    c. Optional: Develop site HCP with FWS for species impacts and offsets to lock-in mitigation requirements;
    d. Optional: Sell or auction off habitat value/mitigation use rights for the identified mitigation lands to mitigation providers (public or private)
5. Work with existing ILF providers to use ASLD holdings for wetland and waters of U.S. mitigation:
    a. Identify high value wetlands and water habitat on ASLD holdings that would be viable for wetland mitigation;
    b. Optional: Enter into agreement with other state agencies (AGFD/ADOT) to provide lands (at market value) for habitat mitigation;
    c. Optional: Could develop habitat value/mitigation rights agreement with public or private providers to develop mitigation sites on lands

6. Per identification of ASLD habitat lands with low development potential (e.g., flood plains, species constraints, slope, etc.), auction off habitat values/mitigation on ASLD holdings:
    a. List for sale or auction of habitat value/mitigation ASLD holdings to public and private entities;
    b. Optional: Allow for longer due diligence period or option arrangements, with the requirement that all site evaluation information (e.g., biology, hydrology, restoration ecology, etc.) be shared with ASLD;
7. ASLD will offer appropriate habitat value/mitigation lands for permittee responsible projects:
    a. ASLD will offer to up viable habitat lands to local projects needing PRM;
    b. Optional: Designate internal contact and produce materials highlights habitat mitigation opportunities on ASLD holdings for public dissemination and outreach (e.g., PRM, ILF, and mitigation and/or conservation bank development).

Other Factors/Considerations:

Given the numerous complexities and potential variations to the establishment of a mitigation program, ASLD may also want to consider, review and/or take the following actions to ensure smooth program development and implementation:

ASLD will need to ensure the legal and fiduciary responsibilities that ASLD holdings have in respect to allowing habitat mitigation to be considered the high and best use:

- Use of appraised value for lands;
- Use of discount rates for valuations based upon regional market demand;
- How to address market uncertainty (e.g., future values)

Currently, some of the state-run ILF (AGFD) may use existing state land holdings to implement mitigation which may result in undervaluing of the true costs of mitigation and could result in the lowering of prices or value for ASLD land holdings for habitat mitigation. Conversely, if the existing mitigation programs were to stop subsidizing the costs of mitigation, the costs of mitigation could increase to the end users (e.g., land costs would now be included in the cost of the mitigation credit or habitat acre cost). Thus, if ASLD were to partner with existing state or local or non-profit programs, an agreement on the use of lands for mitigation may need to be established.

Develop of habitat mitigation land sales that establish a base rate for lands (at current land rates or slightly less than standard land price adjustments associated with rural land sales), but add in a future revenue stream from unit sales (e.g., habitat acres or credits) or percentage of overall value of sales. This approach may prove greater incentives for private habitat bankers and green investors to participate in these programs and may provide a competitive advantage over other land owners.